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C O N F I D E N T I A L SECTION 01 OF 02 BAGHDAD 004447

SIPDIS

STATE PASS TO USAID

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TAGS: [ECON](#) [EFIN](#) [PGOV](#) [PREL](#) [MCAP](#) [IZ](#) [IMF](#)

SUBJECT: IMF DISCUSSIONS WITH IRAQ: CHALABI

REF: BAGHDAD 4407

Classified By: CDA David M. Satterfield for reasons 1.4(b) and (d).

11. (C) Summary: In a wide-ranging discussion with CDA Satterfield, DPM Chalabi emphasized the need for a less alienating security posture vis--vis the minority Sunni population, including the use of lower tier former Baathist officers to lead operations in sensitive areas. On security of infrastructure, Chalabi was downbeat, noting the ability of the insurgents to target pipelines and electrical towers with impunity. Concerning the 2006 budget, Chalabi expressed frustration about security estimates and flagged procurement, life support, and operational needs (for both MoD and MoI) for thorough examination. Finally, despite recent commitments made by the GOI to initiate major changes in its major subsidy programs -- the Public Distribution System (PDS) for foodstuffs and the state fuel sales system -- Chalabi was dismissive of possibilities for more rapid reform to stem budget outflows and curb corruption. End Summary.

Concern about Sunni Alienation

12. (C) CDA Satterfield, accompanied by EconMinCouns and Treasury Attache met with Deputy PM Ahmad Chalabi October 23. Chalabi opened the discussion with a short description of several recent audiences with members of the public. One of these, with the families of 36 Sunnis recently executed by individuals passing themselves off as members of the Volcano Brigade of the MOI, Chalabi found particularly appalling. Chalabi noted that those executed were "simple people, not terrorists." He flagged the need to get the Sunni community around Baghdad positively engaged. Toward that end, he is encouraged by the recent recruitment and results achieved by a Sunni battalion commander in Latafiya, a former officer in the old regime army. Chalabi acknowledged that he was a "4th level Baathist" but emphasized that the way forward necessitated using such people who could drastically cut back on the level of alienating incidents. He also noted that he had already spoken to the UK Ambassador and CG Casey about the need to get "action" on this issue before the December election.

Losing the Battle on Infrastructure Security

13. (C) The constant cutting with "impunity" of power lines and pipelines in recent weeks led Chalabi to observe that "we have lost this battle," even though he conceded that the "perfectly reasonable (protection) plan" drawn up by MNSTC-I probably would show results in a few weeks' time. He added that, as a result of deficient intelligence, the GOI still does not know who is planning, funding or executing the attacks. Chalabi argued that it is a mistake to depend on infrastructure security battalions (SIBs), since local "penetrated" elements within them are part of the problem. He recommended their integration into the army and their regular rotation - although not to tribal areas. Chalabi also sought the introduction of better technology: inexpensive UAVs (not Predators) for surveillance; creation of a command and communication center to quickly dispatch react teams to trouble spots (n.b., already done); and a combination of hardening and redundancy to add to the physical security of the lines. To cope with the intimidation of repair crews by insurgents, Chalabi agreed that it would make sense to move these workers to areas where their families could not be targeted. Finally, he stressed the need to change the incentive structure for SIBs and tribes charged with pipeline security. At present, they are paid whether or not the pipelines or transmission towers in their areas of responsibility are hit, leading to suspected "double dipping" (i.e., insurgents paying security elements to destroy towers and lines).

Security Budget and Lagging Capacity

14. (C) Turning to the subject of the pending agreement with the IMF on a Standby Agreement (SBA), Chalabi expressed some frustration with the cost estimates submitted for security needs. He observed that procurement, life support and operational needs for both MoD and MoI would need to be thoroughly studied. Otherwise, he opined, expenditures for

security would quickly rise to levels seen over the last two years - perhaps reaching \$11.0 billion. In this area, Chalabi expected little assistance from within MoD, calling it "moribund" and lacking Director Generals with the ability to identify and deal with problems. Regarding MoI, he flagged major problems, including padding of the active duty rolls as well as major equipment and infrastructure needs.

Subsidy Conundrums -----

15. (C) Taking a cue from Chalabi's budget discussion, we pushed to see if he could be interested in more rapid reforms to the two major subsidy programs - the Public Distribution System (PDS) for foodstuffs and the state fuel sales system. In both cases, commitments have been made that aim at major changes. Nevertheless, with just weeks remaining before the national election, Chalabi was clearly in no mood to entertain politically risky moves. On the PDS, he agreed that monetization of the assistance package currently provided needed to be pursued as expeditiously as possible (Note: Nothing new there. End Note.) but offered that the pace of change would be seriously slowed by the lack of banks, post offices or other governmental offices capable of issuing vouchers in lieu of assistance in kind. On fuel price reform, he also did not want to go beyond modest steps recently taken to inch up retail prices paid for all fuels, even though subsidies continue to claim ever-greater shares of the state budget. Nevertheless, he did recognize the debilitating impact of corruption in fuel sales, with state supplies siphoned out of official channels for black market sale. His solution, however, is a desire to reinstitute a system of inspectors first initiated by the CPA to audit government fuel storage facilities and distribution.

Comment -----

16. (C) Chalabi's alarm about infrastructure security is familiar to us from our once a week participation in his Critical Infrastructure Working Group. His concerns to seek concrete solutions to ongoing threats to infrastructure and to adopt a less threatening posture toward the minority Sunni are both worth our cooperation. In addition, we detect genuine frustration, as we have in discussions with MinFin Allawi, over the details of the security budget for 2006. There is real uncertainty over what sort of security package is needed for the Iraqi military. Both Chalabi and Allawi want to streamline the security budget by focusing on priority tasks and ensuring that the budget is not just a mirror image of U.S. outlays. Finally, we attribute some of Chalabi's hesitation to move more rapidly on subsidy reform to simple political calculation, despite the increasing gravity of the budget and fuel situations. However, he also exhibits no understanding of the possibility of using the market as a tool or incentive to secure his goals. As we explained, letting state retail prices float toward black market levels would gain revenues, curb subsidies, encourage investment and inhibit possibilities for insurgency financing from black market activity. Increasing the number of state inspectors instead is a familiar fallback but one unlikely to have any measurable impact.

Satterfield